

Senate Bill No. 1742

CHAPTER 316

An act to amend Sections 3103, 3104, 3416, 3417, 4207, and 4208 of the Commercial Code, relating to commercial law.

[Approved by Governor July 29, 1996. Filed with
Secretary of State July 29, 1996.]

LEGISLATIVE COUNSEL'S DIGEST

SB 1742, Maddy. Commercial law.

Existing law contains various provisions governing the use of a negotiable instrument, defined as an unconditional promise or order to pay a fixed amount of money under certain conditions, and governing the rights and duties of parties with respect to negotiable instruments. A negotiable instrument is a note if it is a promise, and a draft if it is an order, and a check is one recognized form of a draft.

Existing law also provides uniform rules governing the collection by banks of checks and other instruments for the payment of money and the relationship of banks with their depositors in connection with the collection and payment of items.

This bill would include "demand draft" within the definition of a check for these purposes, and define that term as a writing not signed by a customer that is created by a 3rd party under the purported authority of the customer for the purpose of charging the customer's account with a bank, as specified. The bill contains other related provisions.

The people of the State of California do enact as follows:

SECTION 1. Section 3103 of the Commercial Code is amended to read:

3103. (a) In this division:

- (1) "Acceptor" means a drawee who has accepted a draft.
- (2) "Drawee" means a person ordered in a draft to make payment.
- (3) "Drawer" means a person who signs or is identified in a draft as a person ordering payment.
- (4) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.
- (5) "Maker" means a person who signs or is identified in a note as a person undertaking to pay.
- (6) "Order" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one

or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

(7) “Ordinary care” in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank’s prescribed procedures and the bank’s procedures do not vary unreasonably from general banking usage not disapproved by this division or Division 4 (commencing with Section 4101).

(8) “Party” means a party to an instrument.

(9) “Promise” means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

(10) “Prove” with respect to a fact means to meet the burden of establishing the fact (subdivision (8) of Section 1201).

(11) “Remitter” means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(b) Other definitions applying to this division and the sections in which they appear are:

“Acceptance”	Section 3409
“Accommodated party”	Section 3419
“Accommodation party”	Section 3419
“Alteration”	Section 3407
“Anomalous endorsement”	Section 3205
“Blank endorsement”	Section 3205
“Cashier’s check”	Section 3104
“Certificate of deposit”	Section 3104
“Certified check”	Section 3409
“Check”	Section 3104
“Consideration”	Section 3303
“Demand Draft”	Section 3104
“Draft”	Section 3104
“Holder in due course”	Section 3302
“Incomplete instrument”	Section 3115
“Indorsement”	Section 3204
“Indorser”	Section 3204
“Instrument”	Section 3104



“Issue”	Section 3105
“Issuer”	Section 3105
“Negotiable instrument”	Section 3104
“Negotiation”	Section 3201
“Note”	Section 3104
“Payable at a definite time”	Section 3108
“Payable on demand”	Section 3108
“Payable to bearer”	Section 3109
“Payable to order”	Section 3109
“Payment”	Section 3602
“Person entitled to enforce”	Section 3301
“Presentment”	Section 3501
“Reacquisition”	Section 3207
“Special indorsement”	Section 3205
“Teller’s check”	Section 3104
“Transfer of instrument”	Section 3203
“Traveler’s check”	Section 3104
“Value”	Section 3303

(c) The following definitions in other divisions apply to this division:

“Bank”	Section 4105
“Banking day”	Section 4104
“Clearinghouse”	Section 4104
“Collecting bank”	Section 4105
“Depository bank”	Section 4105
“Documentary draft”	Section 4104
“Intermediary bank”	Section 4105
“Item”	Section 4104
“Payor bank”	Section 4105
“Suspends payments”	Section 4104

(d) In addition, Division 1 (commencing with Section 1101) contains general definitions and principles of construction and interpretation applicable throughout this division.

SEC. 2. Section 3104 of the Commercial Code is amended to read:

3104. (a) Except as provided in subdivisions (c) and (d), “negotiable instrument” means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it is all of the following:



(1) Is payable to bearer or to order at the time it is issued or first comes into possession of a holder.

(2) Is payable on demand or at a definite time.

(3) Does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) “Instrument” means a negotiable instrument.

(c) An order that meets all of the requirements of subdivision (a), except paragraph (1), and otherwise falls within the definition of “check” in subdivision (f) is a negotiable instrument and a check.

(d) A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this division.

(e) An instrument is a “note” if it is a promise and is a “draft” if it is an order. If an instrument falls within the definition of both “note” and “draft,” a person entitled to enforce the instrument may treat it as either.

(f) “Check” means (1) a draft, other than a documentary draft, payable on demand and drawn on a bank, (2) a cashier’s check or teller’s check, or (3) a demand draft. An instrument may be a check even though it is described on its face by another term, such as “money order.”

(g) “Cashier’s check” means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(h) “Teller’s check” means a draft drawn by a bank (1) on another bank, or (2) payable at or through a bank.

(i) “Traveler’s check” means an instrument that (1) is payable on demand, (2) is drawn on or payable at or through a bank, (3) is designated by the term “traveler’s check” or by a substantially similar term, and (4) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

(j) “Certificate of deposit” means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank.

(k) “Demand draft” means a writing not signed by a customer that is created by a third party under the purported authority of the customer for the purpose of charging the customer’s account with a bank. A demand draft shall contain the customer’s account number and may contain any or all of the following:



- (1) The customer's printed or typewritten name.
- (2) A notation that the customer authorized the draft.
- (3) The statement "No Signature Required" or words to that effect.

A demand draft shall not include a check purportedly drawn by and bearing the signature of a fiduciary, as defined in paragraph (1) of subdivision (a) of Section 3307.

SEC. 3. Section 3416 of the Commercial Code is amended to read:

3416. (a) A person who transfers an instrument for consideration warrants all of the following to the transferee and, if the transfer is by indorsement, to any subsequent transferee:

- (1) The warrantor is a person entitled to enforce the instrument.
- (2) All signatures on the instrument are authentic and authorized.
- (3) The instrument has not been altered.
- (4) The instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor.

(5) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(6) If the instrument is a demand draft, creation of the instrument according to the terms on its face was authorized by the person identified as drawer.

(b) A person to whom the warranties under subdivision (a) are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

(c) The warranties stated in subdivision (a) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subdivision (b) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(d) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(e) If the warranty in paragraph (6) of subdivision (a) is not given by a transferor under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee.

SEC. 4. Section 3417 of the Commercial Code is amended to read:

3417. (a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time

of transfer, warrant all of the following to the drawee making payment or accepting the draft in good faith:

(1) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft.

(2) The draft has not been altered.

(3) The warrantor has no knowledge that the signature of the drawer of the draft is unauthorized.

(4) If the draft is a demand draft, creation of the demand draft according to the terms on its face was authorized by the person identified as drawer.

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subdivision is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subdivision.

(c) If a drawee asserts a claim for breach of warranty under subdivision (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3404 or 3405 or the drawer is precluded under Section 3406 or 4406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply:

(1) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(2) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subdivisions (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor,



the liability of the warrantor under subdivision (b) or (d) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(g) A demand draft is a check, as provided in subdivision (f) of Section 3104.

(h) If the warranty in paragraph (4) of subdivision (a) is not given by a transferor under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee.

SEC. 5. Section 4207 of the Commercial Code is amended to read:

4207. (a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that all of the following are applicable:

- (1) The warrantor is a person entitled to enforce the item.
- (2) All signatures on the item are authentic and authorized.
- (3) The item has not been altered.

(4) The item is not subject to a defense or claim in recoupment (subdivision (a) of Section 3305) of any party that can be asserted against the warrantor.

(5) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(6) If the item is a demand draft, creation of the item according to the terms on its face was authorized by the person identified as drawer.

(b) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item (1) according to the terms of the item at the time it was transferred, or (2) if the transfer was of an incomplete item, according to its terms when completed as stated in Sections 3115 and 3407. The obligation of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor cannot disclaim its obligation under this subdivision by an indorsement stating that it is made “without recourse” or otherwise disclaiming liability.

(c) A person to whom the warranties under subdivision (a) are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the item plus expenses and loss of interest incurred as a result of the breach.

(d) The warranties stated in subdivision (a) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty



is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(e) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(f) If the warranty in paragraph (6) of subdivision (a) is not given by a transferor or collecting bank under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee nor to any prior collecting bank of that transferee.

SEC. 6. Section 4208 of the Commercial Code is amended to read:

4208. (a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that all of the following apply:

(1) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft.

(2) The draft has not been altered.

(3) The warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized.

(4) If the draft is a demand draft, creation of the demand draft according to the terms on its face was authorized by the person identified as drawer.

(b) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subdivision is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (1) breach of warranty is a defense to the obligation of the acceptor, and (2) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subdivision.

(c) If a drawee asserts a claim for breach of warranty under subdivision (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3404 or 3405 or the drawer is precluded under Section 3406 or 4406 from asserting against the drawee the unauthorized indorsement or alteration.



(d) If (1) a dishonored draft is presented for payment to the drawer or an indorser or (2) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subdivisions (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(g) A demand draft is a check, as provided in subdivision (f) of Section 3104.

(h) If the warranty in paragraph (4) of subdivision (a) is not given by a transferor under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee.

SEC. 7. This uncodified section expresses the Legislature's intent in enacting new subdivision (k) of Section 3104 of the Commercial Code.

Section 3104(k) is new. Modern check collection methods have increased the risk on payor banks that items not bearing authorized signatures may be paid against customer accounts. The purpose of this change is to define a new class of payment instrument, drawn on a bank customer's account without an authorized signature, and to shift the risk of loss for processing this instrument to the depository-collecting bank which is in the best position to prevent its introduction into the check collection system.

The definition of "demand draft" is intended to identify a payment instrument created to debit a bank customer's account with the bank by a party who is not a signer on the account. This payment instrument is not signed by an authorized signer on the account and does not bear or purport to bear a signature of an authorized signer. This payment instrument is intended to debit the bank customer's account by deposit and collection through the normal check collection system. A demand draft may be created by a third party, such as a telemarketer, with the authorization by the bank customer to obtain payment from the bank customer's account as a means to pay the third party. A demand draft may also be created by a third



party such as a home banking service provider, as a means to pay itself or others. The customer's account number and other processing information is encoded on the demand draft and the demand draft is deposited in a bank for collection through normal banking channels and payment by the payor bank. Because checks and other items deposited for collection are processed rapidly and in high volume, payor banks are not able to determine if customers authorize the creation of demand drafts. The depository bank, which is charged with knowing its customer, is in the best position to avoid the introduction into the check collection system of an unauthorized demand draft by scrutinizing the customers allowed to deposit those drafts. This change creates an additional warranty in the case of a demand draft to each transferee that the demand draft was authorized by the bank customer upon whose account it is drawn. This change shifts the risk to the depository bank if its customer deposits an unauthorized demand draft for collection.

Demand drafts do not include instruments that bear forged or unauthorized signatures of customers. Demand drafts do not include instruments drawn or purportedly drawn and signed by a "fiduciary" as defined in Commercial Code Section 3307(a)(1). Instruments bearing forged or unauthorized signatures should be handled under the forgery provisions and unauthorized signature provisions of Divisions 3 and 4 of the Commercial Code, as applicable.

Application of this section is illustrated by two examples:

Case No. 1

X contacts Y by telephone or otherwise. X obtains Y's account number with Bank A and creates an instrument payable to X that lists Y as the maker of the instrument and has Y's bank account information encoded with magnetic ink character recognition symbols on the bottom of the instrument. In the signature block X affixes a stamp that states "SIGNATURE ON FILE." X deposits the instrument into X's account at Bank B. Bank B presents the instrument to Bank A for payment. Bank A pays the check and deducts the funds from Y's account. Y claims that he or she did not authorize the creation of the instrument to debit Y's account and Y did not receive any benefit from the payment. In this case, the instrument qualifies as a demand draft. Bank A has a breach of warranty claim against Bank B under Section 4208(a)(4) of the Commercial Code. Even if X had not affixed the stamp stating "SIGNATURE ON FILE" or included the name of Y on the instrument, the instrument would qualify as a demand draft because Y's bank account information is printed by encoding on the bottom of the instrument.

Case No. 2

Same facts as Case No. 1 except X includes Y's name on the instrument and by error or with intent X has Z's bank account information at Bank A encoded on the bottom of the instrument.



Both Y and Z claim they did not authorize the instrument and did not receive benefit from the payment. The instrument qualifies as a demand draft. Bank A has a breach of warranty claim against Bank B under Sections 4208(a)(4) and 4209 of the Commercial Code.

Case No. 3

X fraudulently issues a check payable to Y drawn on Z's account with Bank A and signs the check "X attorney-in-fact for Z." Y deposits the check into Bank B, who presents the check to Bank A. Bank A pays the check and deducts the funds from Z's account. Z claims the check was not authorized and that X is not Z's attorney-in-fact, and that Z received no benefit from the payment. In this case, the check is not a demand draft because the signature of X is on the instrument as a fiduciary.

